

## Confident About Compliance?

The pressures on captives and captive managers to ensure full compliance with Insurance Premium Tax (IPT) regulation have increased over the past few years and are likely to grow further, creating a strong need for effective, streamlined solutions.

These pressures are coming from governments, national tax authorities, regulatory bodies, and, by extension, from captives' parent organisations.

For governments looking to improve revenue collection, a tax such as IPT is a prime candidate for increased attention. From 1 March this year, IPT in the Netherlands increased from 7.0% to 7.5%, and last year the UK saw the implementation of anti-avoidance legislation, which has tightened the definition of a premium and thereby made a wider range of insurance payments liable for IPT.

Coordination between member states is also developing: the EU Mutual Assistance Directive allows national authorities to share information with each other for tax collection purposes. However, an actual harmonisation of IPT schemes between member states, which would greatly simplify IPT compliance for cross-border operators, remains very unlikely for the foreseeable future.

Regulators are paying closer attention to IPT, too. The UK's Financial Services Authority (FSA) can take action against firms that do not operate what it sees as effective financial controls – and these include efficient IPT payment systems. An incident of non-compliance can be classified as a 'Notifiable Event', and can potentially lead to an investigation and fines. In the US, Sarbanes-Oxley, to which many US and non-US companies are subject, demands compliance in all areas of business, which, again, includes IPT.

Corporations and captive parents are becoming more and more aware of this increased scrutiny and are working hard to ensure that their compliance is watertight. In support of this, captive managers have increasingly made it their business to inform clients about the subject. As Brendan Duggan of Willis International Captive Practice comments, "Traditionally, the insurance world had not been greatly focused on IPT compliance. That has all changed and compliance is today far more regularly discussed. Part of the role of captive managers is to encourage awareness and, in doing so, keep the issue high on the management agenda".

As a natural result, clients are demanding more detail from their insurers on how their IPT liabilities are dealt with. This has become particularly relevant since the Kvaerner case of 2001, which set a precedent enabling national tax authorities to pursue insureds for IPT that their insurers have not paid. Inadequate systems, lack of knowledge, or human error can put insurers and their clients at risk of unexpected bills and fines, and, just as significantly, reputational damage. As Duggan says, "There is a realisation that compliance is not optional or subject to a cost/benefit analysis – the potential for reputational harm is just too great."

Last year's court case involving UK retail group DSG (the former Dixons Group) was the first example of UK tax authorities applying the Kvaerner precedent in their attempt to collect IPT. Despite a good outcome for DSG – a tribunal decided in its favour – the case demonstrates that national tax authorities are prepared to cite Kvaerner when pursuing IPT payments.

The case also highlights the complexity of IPT rules, particularly in relation to Location of Risk. In the EU, IPT liability occurs in the jurisdiction where the risk is covered, not where the insured is domiciled. DSG won

because the Location of Risk was decided to be the IPT-free Isle of Man. Ultimately, the case demonstrates that to get IPT right in the EU, insurers require access to a high level of tax expertise.

Compliance with IPT in the EU involves a challenging series of decisions and processes, some of which are familiar to captives, some of which may be outside their field of knowledge. The location of risk needs to be agreed, as does the class of business or asset to be insured. The appropriate premium and thus the amount of local tax can then be calculated. Companies need to register with the tax authorities, methods of payment need to be established and in some countries local representatives need to be appointed.

Brendan Duggan describes how Willis, as a captive manager, now sees educating clients about IPT compliance issues as an important part of its role: "Managing captives is not simply an administrative service to be sold homogenously - we offer our clients added value, such as by taking time at client board meetings to educate and disseminate information on premium tax compliance."

As the administrative burden of IPT compliance can be quite considerable, this is an area in which captive owners are looking for new efficiencies. While part of the captive manager's job is to make clients aware of the problem, the challenge is also naturally to come up with a solution. Some of the more progressive managers are responding by adopting new measures to provide the required level of cost-effective assurance. Willis, for example, is amongst those firms to have brought in external specialist support, effectively outsourcing the IPT compliance process to FiscalReps in certain situations, as appropriate to the needs of particular clients.

An end-to-end compliance solution, such as that provided by FiscalReps, encompasses all the intricacies of EU IPT payments: keeping on top of regulatory changes wherever they occur, providing representation where it is required, and calculating and paying IPT according to local rules. In addition, through economies of scale, a specialist firm can sustain the costs of maintaining an EU-wide network of offices, with multi-lingual capabilities and a deep knowledge of local regulations and practices. Complete transparency is also assured, with full documentation at all stages of the compliance process, including proof of payment.

"A fundamental decision when opting for such arrangement is naturally cost," says FiscalReps' sales and marketing director Chris James. "However, companies are increasingly recognising that the investment they make needs to be compared to the much larger potential cost of fines, litigation and brand damage should their compliance be inadequate."

In fact, the direct costs of compliance can now be far lower than in the past. Finding a way to manage IPT compliance used to be costly and laborious, and as a result was often neglected. Clearly, that situation is no longer acceptable and it is therefore a welcome development that clients can benefit from solutions that deliver IPT compliance in a more cost-effective manner.

Through measures such as these, the insurance industry is once again responding to the needs of its clients. IPT compliance need no longer be a hidden exposure to catch out the unwary, nor an excessively costly deterrent to covering risks. By ensuring that IPT is addressed from the outset, captives can now rest easy that their corporate governance obligations are met.

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